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After Jackson, EPA faces decisions on U.S. fracking boom

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By Jonathan Leff and Joshua Schneyer

NEW YORK (Reuters) - The past four years of U.S. environmental regulation was marked by a crackdown on emissions that angered coal miners and power companies. Over the next four, the new head of the Environmental Protection Agency will have to decide whether to take on an even larger industry: Big Oil.

Following Lisa Jackson's resignation on Wednesday, her successor will inherit the tricky task of regulating a drilling boom that has revolutionized the energy industry but raised fears over the possible contamination of water supplies.

The controversial technique at the center of the boom, hydraulic fracturing, involves injecting millions of gallons of water laced with chemicals deep into shale rocks to extract oil and gas. It has become a flashpoint issue, putting the EPA -- charged with safeguarding the nation's water -- in the middle of a fight between environmentalists and the energy industry.

Both sides now eagerly await a major EPA research project into fracking's effects on water supplies due in 2014, as well as final rules on issues including the disposal of wastewater and the use of 'diesel' chemicals in the process.

It is unclear who will take the role, but the incoming chief may have a "huge impact" on the oil and gas industry, says Robert McNally, a White House energy adviser during the George W. Bush administration who now heads the Rapidan Group, a consulting firm.

On the one hand, energy industry and big manufacturers are warning the EPA not to impede a drilling boom that offers the promise of decades' worth of cheap energy. Meanwhile, environmentalists are pressing President Barack Obama to ensure the drilling bonanza is not endangering water resources.

"This administration clearly needs contributors to economic growth for its economic legacy as much as it needs to add to its environmental legacy," said Bruce Bullock of the Maguire Energy Institute at Southern Methodist University in Dallas.

"This appointment could be key in seeing which of those two legacies is more important."

There are many contenders for the role, but no clear front-runner as yet. Obama may seek an insider to avoid a difficult confirmation process, with possible candidates including Bob Perciasepe, the EPA deputy administrator and interim chief, and Gina McCarthy, who runs the air quality division.

Obama is unlikely to win Congressional approval for a heavy-handed regulator, and there is no suggestion of a stringent crackdown.

Even Jackson, who suffered withering criticism from big industry and Republicans for her efforts to curb pollution and limit greenhouse gas emissions, has cautiously condoned the practice as safe, while acknowledging the need for greater study and, in some cases, oversight.

"(Fracking technology) is perfectly capable of being clean," Jackson said in February. "It requires smart regulation, smart rules of the road."

Jackson's successor may now be charged with refining those rules, and both energy companies and fracking critics are anxious about the outcome.

Industry body Independent Petroleum Association of America said the EPA has "hindered development" of oil and gas for four years, and looks forward to a new chief who will promote energy drilling "hand in hand" with environmental regulation.

Executive director of the Sierra Club environmental group Michael Brune says the EPA has "unfinished business" in addressing things such as the release of methane emissions during fracking.

## APPETITE TO REGULATE

Some analysts say Obama will not risk the economic stimulus of cheaper, domestic energy by pushing for tougher regulations. The oil sector is one of the few bright spots in the U.S. economy; natural gas prices are near their lowest in a decade, a boon for manufacturers, and U.S. oil output is the highest in 18 years.

"Even before (Jackson's resignation) there didn't seem to be much of an appetite in the White House to regulate shale drilling on a federal level in the next couple of years," says Nitzan Goldberger, U.S. energy policy analyst with Eurasia Group.

But big drillers such as ExxonMobil and Chesapeake who have plowed billions of dollars into shale fields are watching carefully for any sign of new rules or oversight.

Mark P. Fitzsimmons, a former lawyer in the Department of Justice's environmental division, and now a partner at Steptoe & Johnson LLP in Wash DC, says there is "a risk of overregulation." Some drilling activity has already slowed sharply this year due to the slump in natural gas prices.

"Regulatory overlays that add to the cost of production will further slow down development" but won't stop it, he said.

While fracking technology has been around for decades, it has only gained widespread use across dozens of states in recent years. The EPA, like many groups, has struggled to keep up with the expansion, according to Government Accountability Office reports released earlier this year.

After years in which states were mostly responsible for regulating onshore drilling, the new EPA administrator will be pressed to take a more central role.

A year ago, in the first U.S. government report of its kind, the EPA drew a potential link between water contamination in rural Pavillion, Wyoming and fracking, based on samples of ground water from the area. That study has been contested, and subsequent research has been inconclusive.

A firmer word on the impact may not emerge until 2014, when the EPA is expected to release the first exhaustive in-depth government study on the long-term effects of fracking on drinking water, commissioned by Congress over two years.

While climate change issues and air pollution may remain larger agency priorities, fracking is moving up the agenda.

"I don't think they would be capable of ignoring something that Matt Damon makes a movie about," said Fitzsimmons.

Damon and John Krasinski star in "Promised Land," a new film that opened on Friday exploring the social impact of fracking. It received mixed reviews from critics, but is being closely watched by an energy industry that fears it could further antagonize public opinion over domestic drilling.

A Gallup poll this year showed drinking water contamination is the leading environmental concern among Americans.

#### DIESEL, WASTEWATER AND FLARING

The debate rages over a diverse range of issues.

While fracking was exempted from the Federal Clean Water Act in 2005, operations that used diesel fuel, which contains a number of toxic chemical compounds, were not exempted.

However, what exactly constitutes "diesel" has been a bone of contention among oil firms and environmental groups.

"The question is how to define "diesel" - broadly or narrowly," says consultant McNally.

"It's a big issue especially for Bakken producers," he said, referring to the region of North Dakota where crude oil output has more than tripled in two years.

The EPA published a draft definition in May, which met with criticism from the industry and some legislators, but it will fall to the new administrator to set a final definition.

Under Jackson, the EPA also said it would begin to regulate the millions of gallons a day of wastewater that is withdrawn from wells after the fracking process, probably in 2014. This is usually trucked offsite and sometimes re-injected elsewhere, although increasingly it is being reprocessed for further use.

And eventually, the EPA could face pressure to backtrack on previous initiatives. In April, the agency relented to pressure from the industry, giving drillers until January 2015 to end the practice of "flaring" excess natural gas from wells that were not connected to pipelines. It had initially proposed that firms cease almost immediately.

For Jackson's successor, a central question is whether the EPA takes a broader role in the industry, or, as Jackson hinted a year ago, allows state officials to call most the shots when it comes to drilling:

"It's not to say that there isn't a federal role, but you can't start to talk about a federal role without acknowledging the very strong state role."

(Additional reporting by Selam Gebrekidan and Valerie Volcovici; Editing by Joseph Radford and Andrew Hay)

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